

Financial Considerations

How do I determine ahead of time that my farm business arrangement can achieve the financial performance adequate to satisfy everyone involved?

In cases where an existing business will not be substantially changed, the existing financial records can be most valuable for this purpose.

In cases where the farm business arrangement involves a substantially different operation or the existing records are sketchy, it becomes necessary to do projections based on sample budgets. In all cases, there are several financial statements that should be included in the analysis. The three most important ones are:

1. Balance Sheet or Net Worth Statement or Financial Statement
2. Net Farm Earnings Statement (also known as Income Statement, Operating Statement or a Profit and Loss Statement,
3. Cash Flow Statement

For all but the most simple farm business arrangements all three of the above documents should be produced and analyzed for each participating parties. Another set of these documents should be prepared for the new farm business arrangement structure. Most farm account record books and farm accounting computer software programs will have some form of these documents in them.

Balance Sheet

The balance sheet is especially helpful in measuring the business goal known as solvency. (Solvency is the ability to meet all the financial obligations in the long run.)

The balance sheet is a listing of all assets (what is owned), liabilities or debt, and net worth at a certain point in time.

It is recommended that business and personal assets and liabilities be kept on separate balance sheets. If personal assets and liabilities are included on the business balance sheet, at least segregate them and clearly identify each.

Each asset on the balance sheet should have two values. One is the tax basis value. The other is the current market value. The two valuation tracks should not be intermixed.

The current market value will be the basis for determining the capital contributions of each party in the business arrangement. The tax basis is necessary for considering the tax implications of the farm assets.

Debt owed is a key aspect in forming the farm business organization. The lender holding the debt will need to be consulted when shifting assets to a new form of farm business organization. In fact, the lender may have veto power over what assets can and cannot be transferred.

The balance sheets found on farms and requested by lenders tend to have one value for assets and the value is likely to be current market value. It should be relatively easy to establish the tax basis value of assets because most of them can be found on other documents that are readily available. The documents that can provide some of the tax basis asset values include:

1. The detailed depreciation schedule from the latest income tax return should provide the tax basis of purchased

breeding stock, buildings, equipment and machinery.

2. Land documents such as abstracts, deeds, land contracts, sales contracts and mortgages will often reveal the tax basis of land.

Farm Earnings Statement

The farm earnings statement is especially helpful in measuring the business goal called profitability.

The farm earnings statement is a summary of income and expenses for a period of time (usually a calendar year). The farm earnings statement should also show how much money was made by the business. Ideally, the profit or loss calculation on the farm earnings statement includes adjustments in inventory and asset tax basis values.

Including these adjustments should show whether or not the income from business sales could meet all operating expenses, provide replacement capital, pay any income taxes, and generate money for family living expenses.

The farm earnings analysis should help determine whether or not the farm business arrangement is likely to consistently generate enough profit to satisfy all of the people involved.

Care should be taken not to become too optimistic when projecting the farm earnings for future years under expansion conditions. If a well-constructed farm earnings statement has not been prepared, federal tax schedule F, form 4797 and a cost basis balance sheet can provide much of the information needed for a complete well-constructed farm earnings statement.

Cash Flow

Cash flow and profitability are not the same. Since they both are important concepts in farm financial management, the impact that a farm business arrangement will have on both of them should be examined.

In rough terms, profitability is income minus expense. Ideally the difference is positive and large. In contrast, cash flow is money in and money out. Cash flow doesn't differentiate between money that is earned and money that is borrowed or received as a gift or prize. Not all income and expenses are in the form of cash.

There must be adequate cash to provide all cash needs for both the farm business and the farm families or the farm business arrangement will fail. A cash flow statement gives the sources and outlays of cash. Cash sources include any farm sales and non-farm income, loans, and gifts. Cash outlays include all cash farm expenses, farm capital purchases, family living expenses, income taxes and payment on debt.

While personal financial details are often not needed or included on the farm earnings statement or the balance sheet, non-business cash flows should be included in the cash flow projection prepared for each individual in the farm business arrangement. Finding the amount of cash needed for family living can help determine how much profit is needed from the farm business arrangement to succeed.

Each family has differing needs for family living so the cash flow needed must be based on that particular farm family. The level of debt servicing is another key consideration in the cash flows. Often younger farm families entering the farm business arrangement have large debts to service because they have



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recently acquired assets for farming. At times, these large debt payments can make it difficult to have a positive cash flow. For the farm business to be successful, there must be sufficient cash flows for all farm expenses, for cash needs of the farm family and for debt service.

Most people find it useful to do a monthly cash flow projection for the entire year at the beginning of the year and then compare the actual cash flow with the projections.

When preparing your first cash flow document for an existing operation, the farm earnings statement, federal tax schedule F, your loan records and your checkbook can provide much of the raw data you need to project your cash flow



Family Living Worksheet

Family Name _____ Date _____
 Address _____ Zip _____

	ACTUAL	PLANNED
NET MONTHLY INCOME		
Family Draw From Farm Business	\$ _____	\$ _____
Non Farm Income	\$ _____	\$ _____
Income From Savings & Investments	\$ _____	\$ _____
TOTAL NET MONTHLY INCOME (From all sources)	\$ _____	\$ _____

MONTHLY EXPENSES

HOUSING

Rent or Mortgage Payment	\$ _____	\$ _____
Maintenance (Cleaning products/repairs)	\$ _____	\$ _____
Utilities		
Electric	\$ _____	\$ _____
Gas/Oil _____	\$ _____	\$ _____
Water _____	\$ _____	\$ _____
Phone _____	\$ _____	\$ _____
Cable _____	\$ _____	\$ _____
Cell phone _____	\$ _____	\$ _____
Other _____	\$ _____	\$ _____

FOOD

Food at home (groceries—food only)	\$ _____	\$ _____
Food away from home		
Eating out	\$ _____	\$ _____
School lunch	\$ _____	\$ _____
Infant formula/food	\$ _____	\$ _____
Other _____	\$ _____	\$ _____

TRANSPORTATION

Car payment _____	\$ _____	\$ _____
Maintenance		
Gas _____	\$ _____	\$ _____
Oil _____	\$ _____	\$ _____
Repairs _____	\$ _____	\$ _____
License _____	\$ _____	\$ _____
Tires _____	\$ _____	\$ _____



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Insurance	\$ _____	\$ _____
Public Transportation	\$ _____	\$ _____
Other _____	\$ _____	\$ _____

MEDICAL/DENTAL

Medical	\$ _____	\$ _____
Dental	\$ _____	\$ _____
Hospital	\$ _____	\$ _____
Eye care	\$ _____	\$ _____
Prescriptions	\$ _____	\$ _____
Over the counter medications	\$ _____	\$ _____
Health Insurance	\$ _____	\$ _____
Other _____	\$ _____	\$ _____

OTHER CREDIT (unsecured loans—)

Credit Cards	\$ _____	\$ _____
Other _____	\$ _____	\$ _____

CLOTHING AND PERSONAL

Clothing	\$ _____	\$ _____
Shoes & Boots	\$ _____	\$ _____
Diapers	\$ _____	\$ _____
Laundry	\$ _____	\$ _____
Hair cuts/beauty shop	\$ _____	\$ _____
Personal products	\$ _____	\$ _____
Other _____	\$ _____	\$ _____

EDUCATIONAL/RECREATION

School expenses	\$ _____	\$ _____
Lessons (sports, music, dance, etc.)	\$ _____	\$ _____
Books, papers, magazines	\$ _____	\$ _____
Video rentals/movies	\$ _____	\$ _____
Vacations/trips	\$ _____	\$ _____
Hobbies/sports	\$ _____	\$ _____
Other _____	\$ _____	\$ _____

CONTRIBUTIONS/GIFTS

Church	\$ _____	\$ _____
Charitable contributions	\$ _____	\$ _____
Gifts/birthdays, holidays	\$ _____	\$ _____
Other _____	\$ _____	\$ _____

CHILD CARE



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Child care/day care	\$ _____	\$ _____
Babysitting	\$ _____	\$ _____
Other _____	\$ _____	\$ _____
OTHER		
Life insurance	\$ _____	\$ _____
Emergency fund	\$ _____	\$ _____
Checking acct./money order fees	\$ _____	\$ _____
Stamps/postage	\$ _____	\$ _____
Union/work expenses	\$ _____	\$ _____
Pet food & care	\$ _____	\$ _____
Cigarettes	\$ _____	\$ _____
SAVINGS	\$ _____	\$ _____
TOTAL MONTHLY EXPENSES	\$ _____	\$ _____
DIFFERENCE (+) OR (-)	\$ _____	\$ _____

Adapted from:

Volunteer Family Financial Counseling Program

Partnering Agencies: Homeless Prevention Project of Washington County

Washington County University of Wisconsin Extension

Volunteer Center of Washington County

GLOSSARY
Financial Considerations

Balance Sheet

Net Worth Statement
Financial Statement

Farm Earnings Statement

Income Statement
Operating Statement
Profit or Loss Statement

Cash Flow

Statement of Cash Flow

Exercise
SWOT Analysis I

When completing the SWOT analysis consider the type of business arrangement, transfer of farm assets and debts, and the transfer of management and labor resources.

Internal

(those factors the family has control over)

Strengths:

Weaknesses:

External

(those factors that are outside the control of the family)

Opportunities:

Threats: